Supreme Court, U.S.
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No. 02-

IN THE

Supreme Court of the United States

OAKLEY-AVALON, L.P.,

Petitioner,

v.

GARY DEAN *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FIRST APPELLATE DISTRICT, DIVISION THREE

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether California courts may – in direct contravention of the goals and policies of the Federal Arbitration Act – use a California statute directed exclusively to arbitration to refuse to enforce arbitration agreements in contracts involving interstate commerce simply because a non-party to the agreement is named in the lawsuit, thereby effectively removing California from the otherwise nationwide application of the Act's liberal enforcement of arbitration agreements.

PARTIES TO THE PROCEEDING

In addition to the parties identified in the caption, the additional Respondents are Sherry Dean, Kevin Nicholas, Tracy Nicholas, Paul Roas and Tahirih Roas. PG&E is also a party to the case but was not a party to the underlying appeal.

The Respondents also named Porter Homes, Western Pacific Housing Corporation and Western Pacific Housing – Porter Division as defendants. "Porter Homes" is merely an authorized dba and is not a distinct legal entity. The two named Western Pacific entities do not exist.

CORPORATE DISCLOSURE STATEMENT

Oakley-Avalon L.P. is an active California limited partnership and is not a corporation.

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Petitioner respectfully prays that a writ of certiorari issue to review the decision of the Court of Appeal of the State of California, First Appellate District, Division Three.

OPINIONS BELOW

The order of the Court of Appeal of the State of California, First Appellate District, Division Three, was issued on September 30, 2002 (App. A) and the Court of Appeal denied Petitioner's Petition for Rehearing on October 25, 2002. (App. C). The Superior Court of California in and for Contra Costa County denied Petitioner's Motion to Compel Arbitration on October 20, 2000. (App. B).

STATEMENT OF JURISDICTION

The Supreme Court of California denied Petitioner's Petition for Review on January 15, 2003. (App. D). This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a).

STATUTES INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides:

> Validity, irrevocability, and enforcement of agreements to arbitrate
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to

> submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 1281.2 of the California Arbitration Act, California Code of Civil Procedure § 1281.2, provides:

> On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that:
>
> (a) The right to compel arbitration has been waived by the petitioner; or
>
> (b) Grounds exist for the revocation of the agreement.
>
> (c) A party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact. For purposes of this section, a pending court action or special proceeding includes an action or

> proceeding initiated by the party refusing to arbitrate after the petition to compel arbitration has been filed, but on or before the date of the hearing on the petition. This subdivision shall not be applicable to an agreement to arbitrate disputes as to the professional negligence of a health care provider made pursuant to Section 1295.

If the court determines that a written agreement to arbitrate a controversy exists, an order to arbitrate such controversy may not be refused on the ground that the petitioner's contentions lack substantive merit.

If the court determines that there are other issues between the petitioner and the respondent which are not subject to arbitration and which are the subject of a pending action or special proceeding between the petitioner and the respondent and that a determination of such issues may make the arbitration unnecessary, the court may delay its order to arbitrate until the determination of such other issues or until such earlier time as the court specifies.

If the court determines that a party to the arbitration is also a party to litigation in a pending court action or special proceeding with a third party as set forth under subdivision (c) herein, the court (1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action or special

> proceeding; (2) may order intervention or joinder as to all or only certain issues; (3) may order arbitration among the parties who have agreed to arbitration and stay the pending court action or special proceeding pending the outcome of the arbitration proceeding; or (4) may stay arbitration pending the outcome of the court action or special proceeding.

STATEMENT OF THE CASE

This case arises from the California courts' refusal to enforce an agreement between the parties to arbitrate. Although it is undisputed that the parties' contract involves interstate commerce and the Federal Arbitration Act therefore governs their agreement to arbitrate, the California courts refused to apply the FAA. Instead, invoking California Code of Civil Procedure Section 1281.2(c) – a statute directed solely to arbitration – the trial court denied Petitioner's motion to compel arbitration because Respondents named non-parties to the arbitration agreement in their lawsuit. The California Court of Appeal affirmed, and the California Supreme Court denied Petitioner's Petition for Review.

It is well established that the FAA imposes a nationwide policy favoring enforcement of arbitration agreements, effective in both federal and state courts. This Court's decisions confirm that the FAA precludes states from enacting statutes that render arbitration agreements involving interstate commerce unenforceable. Yet this is precisely the effect of the portion of Section 1281.2(c) at issue here: it gives California courts the authority to refuse to enforce valid arbitration agreements. Not only does this aspect of the statute contravene the goals and policies of the FAA, but it

effectively removes California from the otherwise nationwide application of these policies. Guidance from the Court on this issue is critical, and this case presents an excellent opportunity for the Court to provide it.

Factual Background

This case was filed by six couples and one individual who purchased homes in a subdivision known as Oakley-Avalon located in Oakley, California. Joint Appendix in Lieu of Clerk's Transcript ("JA"), 1 JA 003, 0025, 0046-0047, 0073-0077, 0079-0083, 0085-0089, 0111-0115, 0117-0121, 0142-0146, 0148-0152. In the construction of those homes, Petitioner used materials and equipment from states other than California. Motion to Consider Additional Evidence, Ex. C.[1] After the homes were constructed and sold, contamination was discovered on adjacent property belonging to PG&E. 1 JA 0004, 0025-0026, 0047-0048. Years before Petitioner commenced construction, PG&E had operated a natural gas dehydration plant known as the Dutch Slough Dehydrator Plant, which caused the groundwater beneath PG&E's property to become contaminated. 1 JA 0003-0004, 0025-0026, 0047-0048. The PG&E contamination extended to the property purchased by one of the Respondents, but no contamination has been found on any of the property purchased by the other Respondents. 1 JA 0004, 0025-0026, 0047-0048.

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1. The Court of Appeal granted Petitioner's Motion to Consider Additional Evidence and Motion Requesting Court to Take Judicial Notice. Pet. App. 10a. Respondents did not oppose or object to Petitioner's motions or evidence.

Respondents filed three actions against Oakley-Avalon[2] and PG&E.[3] 1 JA 0001-0065. The complaints in each of the actions are substantially identical. 1 JA 0001-0065. The Respondents alleged different and non-overlapping claims against PG&E and Petitioner in each of their complaints. Against PG&E, Respondents alleged claims for continuing nuisance, trespass and negligence. 1 JA 0004-0007, 0026-0029, 0058-0061. Against Petitioner, Respondents alleged claims for fraud and misrepresentation, negligent misrepresentation, failure to make material disclosures in violation of California Civil Code § 1102, breach of contract (based on the failure to disclose), and declaratory relief and reformation of purchase agreements. 1 JA 0007-0018, 0029-0042, 0047-0058.

Each of the contracts between Respondents and Petitioner contain an arbitration provision:

> Arbitration of Disputes. In the event of any dispute or controversy between the parties relating to or

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2. Oakley-Avalon, L.P. was the seller of the homes to respondents. Porter Homes, Western Pacific Housing Corporation and Western Pacific Housing—Porter Division were improperly named as defendants in these actions. "Porter Homes" is merely an authorized dba and is not a distinct legal entity. The two named Western Pacific entities do not exist. Nonetheless, to avoid default, all of the entities named as Oakley-Avalon related entities appeared in these actions and joined in the motion to compel arbitration.

3. Petitioner and PG&E are the only remaining defendants in these actions. Respondents dismissed Iron House Sanitation District, Hofmann Construction Company and Hofmann Company from these actions during the pendancy of the appeal. PG&E is not a party to this Petition.

> arising out of this agreement, the property, or the disposition of deposit, then such dispute shall be resolved by binding arbitration in accordance with the provisions of the California Code of Civil Procedure.

1 JA 0069-0070, 0076, 0082, 0088. Pursuant to the arbitration provisions in the contracts, Petitioner promptly brought a motion to compel arbitration of the dispute. 1 JA 0066-0164. The trial court denied Petitioner's motion, citing California Code of Civil Procedure Section 1281.2(c), which authorizes California courts to deny motions to compel arbitration when non-parties to the arbitration agreement are named in the action. Pet. App. 12a. The trial court also denied Petitioner's motion because it found that the alleged contamination was a construction defect and excluded from arbitration under another California statute directed solely to arbitration agreements. Pet. App. 12a.

Proceedings Below

Petitioner appealed, presenting the California Court of Appeal with undisputed evidence that it had used material from other states in the construction of Respondents' homes and legal authority holding that in such a situation the arbitration agreements between the builder and homebuyer are governed by the FAA. *See Basura v. U.S. Home Corporation*, 98 Cal. App. 4th 1205, 120 Cal. Rptr. 2d 328 (Cal. Ct. App. 2002). Nonetheless, when the Court of Appeal issued its opinion on September 30, 2001, it did not address whether the FAA applied to the arbitration agreement and, if so, the effect of that law. Instead, it held that the trial court "did not abuse its discretion in denying [Petitioner's] petitions

[to compel arbitration] under Code of Civil Procedure section 1281.2. . . ." Pet. App. 3a.

On October 14, 2002, Petitioner filed a Petition for Rehearing with the Court of Appeal, requesting rehearing based on the Court of Appeal's omission of any consideration of the applicability and impact of the FAA. On October 25, 2002, the Court of Appeal denied the Petition for Rehearing. Pet. App. 15a. Petitioner then timely filed a Petition for Review with the California Supreme Court. The Supreme Court denied review on January 15, 2003. Pet. App. 16a.

REASONS FOR GRANTING THE WRIT

This case presents an important question of the states' ability to enact statutes that directly undermine the goals and policies of the Federal Arbitration Act. It is undisputed that the contract between the parties to this case involves interstate commerce, and the FAA therefore governs the parties' agreement to arbitrate. However, because the Respondents named non-parties to the contract in the action, the California courts refused to enforce the arbitration agreement. The California courts' decision is directly at odds with both the plain language of Section 2 of the FAA and the well established authority of this Court construing that language.

California has done precisely what federal law says it may not do – it has empowered its courts to refuse to enforce valid arbitration agreements. The part of California Code of Civil Procedure Section 1281.2(c) relied upon by the courts to deny Petitioner's motion to compel arbitration permits California courts to deny arbitration despite a valid arbitration agreement whenever a non-party to the agreement is named in the action. Merely by invoking this statute, California

courts may "nullify" valid agreements to arbitrate in direct contravention of the goals and policies of the FAA.

The impact of this statute is great, particularly since California is the world's fifth largest economy[4] and therefore home to countless commercial arbitration agreements involving interstate commerce. One of the fundamental objectives of the FAA is the creation of a nationwide policy favoring the enforcement of arbitration agreements. This objective is thwarted when any state's courts – and particularly the hundreds of courts located in a major commercial hub like California – are given license to refuse to enforce valid agreements to arbitrate in contracts involving interstate commerce.

This Court previously analyzed whether one portion of Section 1281.2(c) is preempted in *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*, 489 U.S. 468 (1989). At issue in *Volt*, however, was the part of the statute that allows courts to **stay** arbitration pending litigation between non-parties to an arbitration agreement. The Court's analysis did not include the portion of the statute that authorizes California courts to deny arbitration altogether. While the Court concluded in *Volt* that the stay portion of the statute passes muster, the same is not true for the portion at issue here. To the contrary, the part of the statute that empowers California courts to completely deny arbitration must be preempted because it wholly

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4. *See, e.g.*, California Legislative Analyst's Office, *2002 California Facts: Economy* (Dec. 2002), *available at* www.lao.ca.gov/2002/cal-facts/econ.html.

undercuts the goals and policies behind the FAA. The Court should grant the Petition to address the portion of the statute that frustrates the very purpose of the FAA.

I. This Court's Decisions Establish That the Federal Arbitration Act Preempts State Statutes that Render Arbitration Agreements Unenforceable

The FAA governs the enforcement of arbitration provisions in any contract evidencing a transaction involving interstate commerce. 9 U.S.C. § 2. This Court has recognized that Congress enacted the FAA in 1925 to "overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985). In addition, "Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.'" *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). Thus, Section 2 of the FAA "declares that a written agreement to arbitrate in any contract involving interstate commerce or a maritime transaction 'shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.'" *Volt*, 489 U.S. at 474 (quoting 9 U.S.C. § 2).

By requiring that states treat arbitration agreements in the same way they treat other contracts, Congress imposed a statutory scheme that liberally embraces arbitration agreements. As this Court explained, the FAA is "a statute that embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the

Commerce Clause." *Perry v. Thomas*, 482 U.S. 483, 490 (1987). Moreover,

> [i]n enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.

Southland Corporation v. Keating, 465 U.S. 1, 10 (1984). The FAA "establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone Hospital v. Mercury Construction Corporation*, 460 U.S. 1, 24-25 (1983). Accordingly, this Court has held that the FAA requires courts to "rigorously enforce agreements to arbitrate." *Byrd*, 470 U.S. at 221.

Not only did Congress enact the FAA to ensure that courts faced with arbitration agreements governed by the FAA rigorously enforce the agreements, but also to guarantee that all courts, whether federal or state, would reach the same outcome with respect to arbitrability of any particular dispute. *See, e.g., Southland*, 465 U.S. at 11-16 (discussing the intent of Congress to preempt state laws that undermine the enforceability of arbitration agreements). As the Court remarked in *Southland*,

> We are unwilling to attribute to Congress the intent, in drawing upon the comprehensive powers of the Commerce Clause, to create a right to

> enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted.

Id. at 15. A primary goal of the FAA is therefore nationwide consistency in the enforcement of agreements to arbitrate:

> [T]his Court decided that Congress would not have wanted state and federal courts to reach different outcomes about the validity of arbitration in similar cases. The Court concluded that the Federal Arbitration Act preempts state law; and it held that state courts cannot apply state statutes that invalidate arbitration agreements.

Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. 265, 272 (1995) (citing *Southland*, 465 U.S. at 15-16).

State laws that contravene the goals of liberal enforcement of arbitration agreements are preempted by the FAA. Decision after decision of this Court has emphasized that state statutes rendering arbitration agreements unenforceable are preempted because they undermine the goals and policies of the FAA. *See, e.g.*, *Doctor's Associates*, 517 U.S. 681 (finding preemption of Montana statute making arbitration agreements without specific written notice of arbitration provision); *Allied-Bruce*, 513 U.S. 265 (finding preemption of Alabama statute making written, predispute arbitration agreements invalid and unenforceable); *Perry*, 482 U.S. 483 (finding preemption of provision of the California Labor Code that allows actions for the collection of wages to be maintained "without regard to the existence of any private agreement to arbitrate"); *Southland*, 465 U.S. 1 (finding preemption of provision of California Franchise

Investment Law that California courts had interpreted to require judicial consideration of claims arising under the law). Such is the case with this statute.

II. The Portion of California Code of Civil Procedure 1281.2(c) this Court Addressed in *Volt* Determined Only the Efficient Order of Proceedings, While the Provision at Issue Here Affects Enforceability of the Arbitration Agreement Itself

This Court has previously addressed preemption issues with respect to Section 1281.2(c). *See Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*, 489 U.S. 468 (1989). However, the Court's analysis in *Volt* was limited to the portion of the statute that authorizes California courts to stay arbitration pending related litigation involving non-parties to the arbitration agreement, and did not address the portion of the statute invoked by the California courts in this case to completely deny arbitration. As the Court later observed, "[t]he state rule examined in *Volt* determined only the efficient order of proceedings; it did not affect the enforceability of the arbitration agreement itself." *Doctor's Associates*, 517 U.S. at 688.[5]

In *Volt*, the California trial court was presented with the question of whether to enforce an arbitration agreement in a

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5. By emphasizing that *Volt* involved only a delay in arbitration rather than an outright denial, the Court distinguished the state statute at issue in *Doctor's Associates*: a Montana law that declared arbitration clauses unenforceable unless the first page of the contract contained a notice in underlined capital letters that the contract was subject to arbitration. The Court held that Montana's law was "inconsonant with, and therefore preempted by, the federal law." *Id.* at 688.

construction contract between Stanford Junior University and Volt Information Sciences, the company hired by Stanford to install a system of electrical conduits on the Stanford campus. *Id.* at 470. Volt made a demand for arbitration, and Stanford responded by filing an action against Volt in California Superior Court, also naming two other companies who were not parties to the construction contract. *Id.* at 470-71. The trial court applied Section 1281.2(c) to stay the arbitration proceedings pending the outcome of the litigation commenced by Stanford. *Id.* at 471. The California Court of Appeal affirmed, acknowledging that the contract involved interstate commerce and that the FAA governed. *Id.* at 471-72. The California Supreme Court denied Volt's petition for discretionary review. *Id.* at 472-73.

This Court affirmed, characterizing the issue before it as whether "application of Cal. Civ. Proc. Code Ann. § 1281.2(c) is . . . preempted by the FAA to the extent it is used **to stay arbitration** under this contract involving interstate commerce." *Volt*, 489 U.S. at 476 (emphasis added). In concluding that Section 1281.2(c) was not preempted, the Court emphasized that its holding was limited to the portion of the statute that authorizes stays:

> [T]he FAA itself contains no provision designed to deal with the special practical problems that arise in multiparty contractual disputes when some or all of the contracts at issue include agreements to arbitrate. California has taken the lead in fashioning a legislative response to this problem, by giving courts authority **to consolidate or stay arbitration proceedings** in these situations in order to minimize the potential for contradictory judgments.

Id. at 476 n.5 (emphasis added). The Court held that the FAA did not "prevent the application of Cal. Civ. Proc. Code Ann. § 1281.2(c) to **stay arbitration** where, as here, the parties have agreed to arbitrate in accordance with California law." *Id.* at 477. (emphasis added).

Unlike the portion of the statute at issue in *Volt*, the portion of the statute applied by the California courts in this case **does** affect the enforceability of the arbitration agreement itself. Quite simply, the statute enables California courts to deny arbitration despite a valid arbitration agreement whenever non-parties to the agreement are named in the action.

III. The Portion of Section 1281.2(c) That Authorizes California Courts to Refuse to Enforce Arbitration Agreements Should Be Preempted Because It Directly Undermines the Goals and Policies of the FAA and Contravenes Well-Established Authority of this Court

In determining whether or not the provision of Section 1281.2(c) at issue in *Volt* was preempted, the Court noted that the statute would "be pre-empted to the extent that it actually conflicts with federal law – that is, to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" *Volt*, 489 U.S. at 477. "The question before us," the Court continued, "is whether application [of the statute] . . . would undermine the goals and policies of the FAA." *Id.* at 477-78. While the parties in *Volt* were not denied their right to arbitrate (since the arbitration was merely delayed until the litigation concluded), the portion of Section 1281.2(c) at issue here gives California courts the freedom to completely deny parties their right to arbitration.

Indeed, the California courts' ability to completely deny arbitration despite a valid arbitration agreement in a contract involving interstate commerce is contrary to everything Congress intended to accomplish by enacting the FAA. In the seminal *Southland* case, this Court stated that

> [c]ontracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate.

Southland, 465 U.S. at 7. The portion of Section 1281.2(c) authorizing denial of valid arbitration agreements contravenes this fundamental policy of the FAA. In fact, the Court's description of the effect of the statute at issue in *Southland* could have been a description of this case:

> Plainly the effect of the judgment of the California court is to nullify a valid contract made by private parties under which they agreed to submit all contract disputes to final, binding arbitration. The federal Act permits 'parties to an arbitrable dispute [to move] out of court and into arbitration as quickly and easily as possible.'

Id. (quoting *Moses H. Cone*, 460 U.S. at 22).

Just like the statute at issue in *Southland*, as well as the many other state statutes the Court has found to be preempted by the FAA, the provision of Section 1281.2(c) that entitles California courts to refuse to enforce valid arbitration agreements undermines the goals and policies of the FAA.

California is the world's fifth largest economy,[6] so its courts will routinely be confronted with questions of arbitrability in cases involving non-parties to arbitration agreements governed by the FAA. Courts that are hostile to arbitration agreements may invoke Section 1281.2(c) to "nullify" valid arbitration agreements. The power this portion of the statute gives the California courts to pick and choose which arbitration agreements they wish to enforce is a significant threat to the very purpose of the FAA: uniform and nationwide enforcement of arbitration agreements.

Another inevitable consequence of this provision of Section 1281.2(c) is just the result the Court feared in *Southland*: the encouragement and reward of forum shopping. *Southland*, 465 U.S. at 15. But for the California courts' application of Section 1281.2(c), the arbitration agreement at issue here would be enforceable. Federal courts would enforce it. [7] Other state courts would enforce it. Only California courts, applying the portion of Section 1281.2(c) that authorizes them to deny arbitration in multiparty cases,

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6. *See, e.g.*, California Legislative Analyst's Office, *2002 California Facts: Economy* (Dec. 2002), *available at* www.lao.ca.gov/2002/cal-facts/econ.html.

7. The FAA contains no provision similar to Section 1281.2(c) addressing disputes involving multiple parties. *See, e.g., Volt*, 489 U.S. at 475 n.5. However, the FAA requires courts to enforce valid arbitration agreements even if intertwined aribtrable and nonarbitrable claims involve common questions of fact and law. *See, e.g., Byrd*, 470 U.S. at 221 (holding that the FAA requires district courts to compel arbitration of pendent aribtrable claims even if the result is piecemeal litigation); *Moses H. Cone*, 460 U.S. at 20 ("Under the Arbitration Act, an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement").

have refused to enforce the valid arbitration agreement between the parties.

Moreover, it is a simple thing for a party to a valid arbitration agreement to round up additional parties to name in its lawsuit merely to avoid arbitration. Commercial cases often include necessary third parties like insurers and subcontractors who are unlikely to be parties to an underlying contract containing an arbitration clause. So long as the party files its action in a California state court and subjects a third party to the litigation, it may succeed in evading the broad enforceability policies of the FAA that would require arbitration of the dispute.

This inconsistency in the enforceability of arbitration agreements and the strategic maneuvers parties will use to avoid arbitration, as well the power of California courts to selectively refuse to enforce agreements to arbitrate, are the very reasons Congress enacted the FAA. In *Volt*, the Court concluded that its decision gave "effect to the contractual rights and expectations of the parties, without doing violence to the polices behind the FAA." *Volt*, 489 U.S. at 479. The only way to achieve the same result in this case is to deem the remaining portion of Section 1281.2(c) preempted by the FAA.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A — OPINION OF THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE DISTRICT, DIVISION THREE DATED AND FILED SEPTEMBER 30, 2002

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT
DIVISION THREE

A093085

(Contra Costa County
Super. Ct. No. C 00-02257)

GARY DEAN et al.,

Plaintiffs and Respondents,

v.

OAKLEY-AVALON, L.P., et al.,

Defendants and Appellants.

Appendix A

A093086

(Contra Costa County
Super. Ct. No. C 00-02040)

GARY ESPINOLA et al.,

Plaintiffs and Respondents,

v.

OAKLEY-AVALON, L.P., et al.,

Defendants and Appellants.

A093087

(Contra Costa County
Super. Ct. No. C 00-02471)

MARCO MANCILLA et al.,

Plaintiffs and Respondents,

v.

OAKLEY-AVALON, L.P., et al.,

Defendants and Appellants.

Four defendants appeal orders denying their petitions to compel arbitration, raising a variety of arguments. We find

that the court did not abuse its discretion in denying their petitions under Code of Civil Procedure section 1281.2,[1] finding that if the arbitration proceeded there was a risk of conflicting rulings on common issues of law or fact. We therefore affirm without considering alternative grounds on which the motion was also denied.

Background

Plaintiffs, six couples and one individual, purchased homes in the Avalon subdivision in Oakley, California in 1998. The subdivision is adjacent to a Pacific Gas and Electric (PG&E) dehydration station that is no longer in use. Plaintiffs allege that the dehydration system polluted the ground water in the subdivision and that the builders and developers of the subdivision knew about but did not disclose the pollution at the time plaintiffs purchased their homes. Named in the complaints as defendants are PG&E, Porter Homes, Western Pacific Housing Corporation, Western Pacific Housing-Porter Division, Hofmann Construction Company, Hofmann Company, Oakley-Avalon, L.P., and Iron House Sanitation Agency.[2] The three complaints that are consolidated on this appeal each allege causes of action for trespass, nuisance

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1. All section references are to the Code of Civil Procedure unless otherwise noted.

2. Iron House is named only in the Dean and Espinola complaints. It is referred to in the complaints and briefs variously as "Iron House" "Ironhouse" and "Iron Horse." Hofmann Construction Company and Hofmann Company are not parties to this appeal. We shall refer to the remaining defendants except PG & E and Iron House as the "developer defendants."

and negligence against PG&E; and for fraud, negligent misrepresentation, violation of Civil Code section 1102, breach of contract, declaratory relief, rescission and reformation against the developer entities. Two of the complaints also allege a ninth cause of action for "Damages" against Iron House Sanitation Agency, alleging that it negligently maintained its sanitation plant in such a way as to cause additional pollution to plaintiffs' property. This appeal is brought on behalf of Oakley-Avalon, L.P., Porter Homes, Western Pacific Housing Corporation, and Western Pacific-Porter Division.

Appellants moved to compel arbitration of all three actions based upon an arbitration provision in the purchase agreements with the plaintiffs. The relevant clauses provide: "In the event of any dispute or controversy between the parties relating to or arising out of this agreement, the property, or the disposition of [the] deposit, then such dispute shall be resolved by binding arbitration in accordance with the provisions of the California Code of Civil Procedure. [¶] . . . This paragraph does not apply to any action for bodily injury or wrongful death, or any right of action to which California Code of Civil Procedure section 337.1 or 337.15 is applicable." This agreement was signed by each of the plaintiffs and by a representative on behalf of Porter Homes. Although the complaints allege an agency relationship between Porter Homes and Oakley-Avalon, L.P., Western Pacific Housing Corporation, and Western Pacific Housing-Porter Division, the existence of such a relationship is in dispute. In each case, the court denied the petition to compel arbitration, finding that the last sentence of the arbitration agreement quoted above is ambiguous and therefore unenforceable against the plaintiffs. The court also found as a second,

independent reason for denying the petition, that "[t]here are multiple parties and the risk of conflicting rulings on common questions or law [*sic*] exist. C.C.P. § 1281.2(c)."

Discussion

Appellants attack the lower court's orders denying their petitions to compel arbitration on numerous grounds. They argue that the court misinterpreted sections 337.1, 337.15 and 1298.7. Section 337.1 provides a four-year statute of limitations for patent construction defects and section 337.15 provides a ten-year statute of limitations for latent construction defects. Section 1298.7 occurs in the title of the Code of Civil Procedure dealing with real estate contract arbitration and provides: "In the event an arbitration provision is included in a contract or agreement covered by this title, it shall not preclude or limit any right of action for bodily injury or wrongful death, or any right of action to which Section 337.1 or 337.15 is applicable." We need not consider how to interpret these provisions—whether contamination or potential contamination is a patent or latent defect, or whether plaintiffs' claims should be regarded as claims of bodily injury—since the court correctly exercised its discretion under section 1281.2, subdivision (c) when it denied the petition to compel arbitration.

Section 1281.2 gives the court discretion to stay or deny arbitration when there are third parties to the litigation who are not party to the arbitration agreement and there is a risk of inconsistent rulings if the arbitration proceeds. The statute provides that the court must enforce an arbitration agreement "unless it determines that: [¶] . . . [¶] (c) A party to the

arbitration agreement is also a party to a pending court action . . . with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact. . . . [¶] . . . [¶] If the court determines that a party to the arbitration is also a party to litigation in a pending court action . . . with a third party as set forth under subdivision (c) herein, the court (1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action . . . ; . . . (4) may stay arbitration pending the outcome of the court action. . . ."

We review the decision of the trial court for abuse of discretion. (*Henry v. Alcove Investment, Inc.* (1991) 233 Cal. App.3d 94, 101.) "The appropriate test for abuse of discretion is whether the trial court exceeded the bounds of reason. When two or more inferences can reasonably be deduced from the facts, the reviewing court has no authority to substitute its decision for that of the trial court." (*Shamblin v. Brattain* (1988) 44 Cal.3d 474, 478-479.) In *Henry v. Alcove Investment, Inc., supra*, the court applied this standard and affirmed an order staying arbitration. In that case, the issue was whether the defendants had defrauded the plaintiff when they induced him to sign a home loan agreement. In addition to the mortgage company, the plaintiff named as a defendant an individual who had been instrumental in obtaining plaintiff's signature. The loan agreement between the plaintiff and the mortgage company contained an arbitration clause, but it did not apply to the individual defendants. The Court of Appeal found that there were three crucial issues in dispute: (1) whether the individual defendants defrauded the plaintiff; (2) whether the individual

defendants were acting as agents of the corporate defendant; and (3) whether the corporate defendant was liable for the acts of the individual defendants. The court concluded that "the possibility of conflicting rulings on a common issue of fact or law is obvious and the trial court's order is clearly 'in bounds.' " Accordingly, the court upheld the stay of arbitration under section 1281.2, subdivision (c) pending the outcome of the trial against the individual defendants.

In the case at hand, to begin with, it is not clear which defendants are parties to the agreement and would participate in arbitration. Porter Homes is the only defendant signatory to the agreement. On the other hand, the petition to compel arbitration was brought on behalf of all of the developer defendants. Even if arbitration were to include all defendants except for PG&E, Iron House and the Hoffman entities, there would be a risk of inconsistent results. The resolution of the trespass, nuisance and negligence claims against PG&E will entail a factual inquiry as to whether there is any contamination from the dehydration plant and, if so, its extent. Likewise, to succeed in their claims against the developer defendants, plaintiffs will be required to show the extent of any contamination or threat of contamination. The timing of any such contamination will be important to the claims against the developer defendants, but this factual issue, largely dependent on expert testimony, necessarily will also be explored in trying the case against PG&E. If the plaintiffs prevail, it will also be necessary to apportion liability between the various defendants, regardless of the separate theories of liability as against PG&E and the developer defendants. (See, e.g., *C.V. Starr & Co. v. Boston Reinsurance Corp.* (1987) 190 Cal.App.3d 1637, 1642.) Therefore, the trial

court's finding that there is a possibility of inconsistent rulings is amply supported by the record and the exercise of its discretion to deny the petitions to compel arbitration was well within the bounds of reason.[3]

Appellants argue that denying them the right to arbitrate based upon the presence of third parties in the litigation gives plaintiffs the unilateral power to avoid arbitration. However, this very argument was rejected in *Henry v. Alcove Investment, Inc., supra*, 233 Cal.App.3d 94. There the court reasoned that "the Legislature made stay orders in cases involving third parties discretionary in order to avoid the gamesmanship suggested in [defendants'] hypothetical." (*Id.* at p. 102, 284 Cal.Rptr. 255.) The court in *Henry* noted that the existence of third parties does not mean that there

3. In their reply brief, appellants argue that the pending PG & E bankruptcy proceedings will substantially delay the resolution of the litigation, providing an additional reason for which the arbitration should have been compelled. However, while this is a factor, which the trial court might properly consider in determining how to exercise its discretion under section 1281.2, it is not a matter properly raised for the first time on appeal. Although this court, by its order of November 1, 2001, has judicially noticed the filing of the bankruptcy petition on April 6, 2001 and the imposition of an automatic stay, PG & E appears to be going forward with the litigation, as evidenced by its intent to depose the plaintiffs and its joinder in Oakley's motion for a stay based upon grounds independent of the bankruptcy stay, suggesting that the bankruptcy stay may subsequently have been modified or vacated. (See exhibits 11 and 7 attached to Oakley's Petition For Writ of Supersedeas, filed September 5, 2002.) When the trial court reacquires jurisdiction upon conclusion of this appeal, the developer defendants will be free to renew their motion to compel arbitration based upon events that have occurred subsequent to the trial court's initial order from which this appeal was taken.

will be uncritical review by the courts in determining whether arbitration should be denied or compelled, citing to a case in which the California Supreme Court rejected an argument that arbitration should be denied because the plaintiff had named third party defendants. (*Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 714.) "[M]erely naming third party defendants not subject to the arbitration agreement '[falls] far short of showing the existence of third party claims which would create "a possibility of conflicting ruling on a common issue of law or fact." ' " (*Henry v. Alcove Investment, Inc., supra*, 233 Cal.App.3d at p. 102.) Here, the trial court did not automatically deny the petitions because there are other defendants, but concluded that in light of the nature of the overlapping claims there was a genuine possibility of inconsistent results if some claims were resolved in arbitration while others were decided in the pending litigation.

Finally, appellants contend that, rather than denying the petitions, the trial court should only have stayed the arbitration pending the outcome of the litigation between plaintiffs and the other parties. However, under section 1281.2, the trial court has discretion, among other alternatives, either to deny the petition or to stay the arbitration. (*Warren-Guthrie v. Health Net* (2000) 84 Cal.App.4th 804, 813.) Here, the trial court reasonably chose the former, apparently being of the view that there will be little, if anything, left to arbitrate after resolution of all issues that must be decided in the litigation. We perceive no abuse of discretion in this decision.

Appendix A

Disposition

The orders denying petitions to compel arbitration are affirmed.[4]

Pollak, J.

We concur:

McGuiness, P.J.

Parrilli, J.

4. Appellants' motion to consider additional evidence and motion requesting court to take judicial notice are granted.

APPENDIX B — ORDER OF THE CONTRA COSTA COUNTY COURTS, SUPERIOR COURT OF CALIFORNIA DATED OCTOBER 20, 2000 AND FILED OCTOBER 23, 2000

CONTRA COSTA COUNTY COURTS
SUPERIOR COURT OF CALIFORNIA

NO. C 00-02257

GARY DEAN, SHERRY DEAN, KEVIN NICHOLAS, TRACY NICHOLAS, PAUL ROA and TAHIRIH ROA

Plaintiffs,

v.

PACIFIC GAS & ELECTRIC COMPANY, a California corporation; PORTER HOMES, a California corporation; WESTERN PACIFIC HOUSING CORPORATION, a California corporation; WESTERN PACIFIC HOUSING — PORTER DIVISION, a California corporation; HOFMANN CONSTRUCTION COMPANY, a California corporation; HOFMANN COMPANY, a California corporation; IRONHOUSE SANITATION AGENCY; a California corporation; OAKLEY-AVALON, L.P., a limited California partnership, and DOES 1-10 AND 12 through 200, inclusive,

Defendants.

Appendix B

ORDER

Date: October 11, 2000
Time: 9:00 a.m.
Dept.: 6

The Motion to Compel Arbitration came on for hearing on October 11, 2000, in Department 6 of the above-referenced court.

The Court having reviewed all pleadings submitted in support and opposition of this motion, and after hearing all arguments therein, the motion to compel arbitration is denied for the following reasons:

(1) The arbitration agreement that does exist is ambiguous. It excludes "any right of actions to which California Code of Civil Procedure ¶¶ 337.1 or 337.15 is applicable." There are two reasonable interpretations fo the clause. The first is that there will be no arbitration if the statute of limitations has expired. The second is that actions for claims described in the two statutes defects are not to be arbitrated. As the clause is construed against the drafter, the second interpretation is adopted and the claims here are not arbitrable; and

(2) There are multiple parties and the risk of conflicting rulings on common questions or law exist. C.C.P. ¶ 1281.2(c)

IT IS SO ORDERED.

Appendix B

DATED: OCT 20 2000

s/ DAVID B. FLINN
Judge of the Contra Costa
Superior Courts

APPENDIX C — ORDER OF THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE DISTRICT, DIVISION THREE DENYING PETITION FOR REHEARING DATED AND FILED OCTOBER 25, 2002

IN THE COURT OF APPEAL OF THE STATE
OF CALIFORNIA
FIRST APPELLATE DISTRICT
DIVISION THREE

A093085

(Contra Costa County
Super. Ct. No. C0002257)

GARY DEAN et al.,

Plaintiffs and Respondents,

v.

OAKLEY-AVALON, L.P., et al.,

Defendants and Appellants.

Appendix C

A093086

(Contra Costa County
Super. Ct. No. C0002040)

GARY ESPINOLA et al.,

Plaintiffs and Respondents,

v.

OAKLEY-AVALON, L.P., et al.,

Defendants and Appellants.

A093087

(Contra Costa County
Super. Ct. No. C0002471)

MARCO MANCILLA et al.,

Plaintiffs and Respondents,

v.

OAKLEY-AVALON, L.P., et al.,

Defendants and Appellants.

BY THE COURT:

The petition for rehearing is denied.

Date: s/ [illegible] P.J.

APPENDIX D — ORDER OF THE SUPREME COURT OF CALIFORNIA DENYING PETITION FOR REVIEW DATED AND FILED JANUARY 15, 2003

Court of Appeal, First Appellate District,
Division Three – No. A093085
S111318

IN THE SUPREME COURT OF CALIFORNIA

En Banc

GARY DEAN et al.,

Plaintiffs and Respondents,

v.

OAKLEY-AVALON, L.P., et al.,

Defendants and Appellants.

and companion cases

Petition for review DENIED.

s/ GEORGE
Chief Justice